

# **REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE SETSOTO LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Setsoto Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Opinion**

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Setsoto Local Municipality as at 30 June 2014 and its financial performance and cash flow for the year then ended, in accordance with SA Standards of GRAP and the requirements of MFMA and DoRA.

## **Emphasis of matters**

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Restatement of corresponding figures**

8. As disclosed in note 56 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the annual financial statements of the Setsoto Local Municipality at, and for the year ended, 30 June 2013.

## **Material losses**

9. As disclosed in note 50 to the financial statements, material electricity and water losses of R21 690 046 (2013: R16 856 545) and R12 952 459 (2013: R16 251 753) respectively were incurred by the municipality as a result of distribution losses relating to water and electricity.

## **Material impairments**

10. As disclosed in note 5 to the financial statements, a provision for impairment of debtors amounting to R192 724 645 (2013: R152 047 627) has been made with regard to consumer debts amounting to R260 092 967 (2013: R211 711 170).

## **Unauthorised Expenditure**

11. As disclosed in note 46 to the financial statements, unauthorised expenditure of R147 032 593 (2013: R154 181 494) was incurred by the municipality as a result of the municipality's failure to implement adequate budgetary controls.

## **Irregular Expenditure**

12. As disclosed in note 48 to the financial statements, the municipality incurred irregular expenditure of R74 744 136 (2013: R131 973 342) during the year under review due to inadequate controls to fully comply with supply chain management (SCM) processes.

## **Going concern**

13. Note 55 to the financial statements indicates that Setsoto Local Municipality has incurred a deficit of R161 580 925 (2013: 114 290 080). This matter, along with other matters as set forth in note 55, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## **Additional matter**

14. I draw attention to the matter below. My opinion is not modified in respect of this matter:

## **Unaudited disclosure notes**

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.



## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Focus area: Water on pages 44 to 48
  - Focus area: Sanitation on pages 49 to 54
  - Focus area: Roads and storm water on pages 69 to 73
  - Focus area: Electricity on pages 55 to 58
  - Focus area: Housing and Land use on pages 63 to 65
  - Focus area: Waste Disposal on pages 59 to 62
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected development priorities are as follows:

#### **Focus area: Water**

#### **Usefulness of reported performance information**

22. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 50% of the reported objectives and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.

### **Reliability of reported performance information**

23. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

### **Focus area: Sanitation**

#### **Usefulness of reported performance information**

24. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 80% of the reported objectives and 86% of the reported indicators and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.
25. The FMPPI requires the following: Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 29% of the indicators were not well defined. This was due to the non-compliance to the requirements of the FMPPI by management.

### **Reliability of reported performance information**

26. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

### **Focus area: Roads and storm water**

#### **Usefulness of reported performance information**

27. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.
28. The FMPPI requires the following: Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 63% of the targets were not specific. This was due to the non-compliance to the requirements of the FMPPI, by management.



### **Reliability of reported performance information**

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of monitoring of the completeness of source documentation in support of actual achievements and the frequent review of the validity of reported achievements against source documentation.

### **Focus area: Electricity**

### **Usefulness of reported performance information**

30. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.

### **Reliability of reported performance information**

31. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

### **Focus area: Housing and Land use**

### **Usefulness of reported performance information**

32. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, indicators and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.

33. The FMPPI requires the following: Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 40% of the indicators were not well defined. This was due to the non-compliance to the requirements of the FMPPI, by management.

### **Reliability of reported performance information**

34. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to

the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

### **Focus area: Waste Disposal**

#### **Usefulness of reported performance information**

35. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 50% of the reported objectives and 60% of the reported indicators and targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to proper monitoring and review processes not been performed with the compiling of the planning and reporting documents by management.

#### **Reliability of reported performance information**

36. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

#### **Additional matter**

37. I draw attention to the following matter:

#### **Achievement of planned targets**

38. Refer to the annual performance report on pages 44 to 73 for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 21 to 36 of this report.

#### **Compliance with laws and regulations**

39. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

#### **Strategic planning and performance management**

40. The annual performance objectives and indicators for the municipal entity were not established by agreement with the Setsoto Integrated Dairy (Pty) Ltd (SID) and included in the municipal entity's multi-year business plan, as required by section 93C(a)(iv) of the MSA.
41. The performance of SID was not monitored and annually reviewed, as part of the annual budget process, as required by section 93C(a)(v) of the MSA.



42. The annual performance report for the year under review did not include measures taken to improve performance as required by section 46 (1)(c) of the MSA.

43. The performance management system and related controls relating to the planning, monitoring, measurement, review and reporting and how it is conducted, organised and managed, were not maintained as required by sections 38 of the MSA and regulation 7 of the municipal planning and performance management regulations.

#### **Budget**

44. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

#### **Annual financial statements and annual report**

45. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulted in the financial statements receiving an unqualified audit opinion.

46. Consolidated annual financial statements were not prepared, as required by section 122(2) of the MFMA.

47. Consolidated financial statements were not submitted for auditing, within three months after the end of the financial year, as required by section 126(1)(b) of the MFMA.

#### **Procurement and contract management**

48. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).

50. Construction projects were not always registered with the Construction Industry Development Board, as required by Construction Industry Development Regulation 18.

51. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2).

52. Awards were made to providers who are in the service of other state institutions or whose directors/principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

53. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) as well as the Preferential Procurement Regulations.

54. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).

## **Human resource management and compensation**

55. An acting senior manager was appointed for a period of more than six months in contravention of section 56(1)(c) of the MSA.
56. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of the MSA.

## **Expenditure management**

57. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Revenue management**

58. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Consequences management**

59. Unauthorised, Irregular, Fruitless and wasteful expenditure incurred by the municipality was not in all instances investigated to determine if any person is liable for the expenditure, as required by sections 32(2)(a)(ii) and 32(2)(b) of the MFMA.
60. Unauthorised, irregular, fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
61. Contrary to sections 32(2)(a)(ii) and 32(2)(b) of the MFMA, the Council certified unauthorised, irregular, fruitless and wasteful expenditure as irrecoverable without an investigation been conducted by a council committee to determine the recoverability of the expenditure.
62. Authorisation of unauthorised expenditure was not done in an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

## **Internal control**

63. I considered internal control relevant to my audit of the financial statements, annual performance information report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on non-compliance with legislation included in this report.

## **Leadership**

64. The action plans were not adequately monitored and implemented to address internal control deficiencies identified. In certain instances, staff members of the municipality were not held accountable due to the performance management system not being fully implemented at the municipality. Processes to prevent and detect all unauthorised, irregular as well as fruitless and wasteful expenditure were not fully established.



## Financial and performance management

65. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in findings relating to incorrect disclosure or non-disclosure.
66. In certain instances, staff members of the municipality were not sufficiently skilled to ensure that the daily financial transactions were fully and correctly recorded in the records of the municipality. Internal checking of all financial records and transactions was found to be inadequate.
67. The municipality did not always comply with applicable laws and regulations. No formal processes were in place to monitor compliance with legislation, which resulted in the number of reported non-compliance issues. Consequences for poor performance and non-compliance with laws and regulations were inadequate.

*Auditor - General*

Bloemfontein

30 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

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